No. 13390

In the

# United States Court of Appeals

## For the Ninth Circuit

UNITED STATES OF AMERICA, *Appellant,*

— v. —

R. D. MERRILL, *Appellee.*

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE WESTERN DISTRICT OF WASHINGTON, NORTHERN DIVISION

HONORABLE WILLIAM J. LINDBERG, *Judge*

## BRIEF OF APPELLEE

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## BRIEF OF APPELLEE

### JURISDICTION

We concur in the statements of Appellant's Brief (1, 2) regarding the jurisdiction of the District Court and of this court.

### QUESTIONS PRESENTED

We have no quarrel with Appellant's manner of stating the questions here presented (Br. 2, 3).

### STATUTES AND TREASURY DECISION INVOLVED

We believe that Appellant has omitted from its Appendix the Treasury Decision which is actually involved in this case. We will supply the omission in the course of our argument.

We believe that in that Appendix, also, counsel have mistakenly set forth a provision of Washington statutory law (Rem. Rev. Stat. §1517) which deals with ordinary executors and is inapplicable to executors under non-intervention wills. The statutes regarding non-intervention wills and the powers and duties of executors thereunder are Rem. Rev. Stat. §§1462, 1463. These we believe to be relevant and they will be found in the Appendix to this brief, *infra*.

## STATEMENT

The facts in this case are undisputed. Most of them were covered in a written stipulation. The major issue of law now presented to this court is whether, under those facts, Judge Lindberg was right in holding that only ten thousand dollars of an executor's fee of twice that amount which was allowed to Mr. Merrill, the Appellee, by the Probate Court constituted taxable income to him, or whether he was properly taxed on the full amount.

Upon the death of his wife, her will was admitted to probate and Mr. Merrill's nomination as executor with non-intervention powers was confirmed by the Superior Court of King County, Washington, on April 21, 1938 (R. 12, Ex. A). He immediately qualified.

The parties had long been residents of the State of Washington and the only assets of the estate consisted of the decedent's interest in the community property of her husband and herself (R. 12). The estate was at all times fully solvent (Ex. E).

In proceeding to settle the affairs of his wife's estate, upon his qualification as the non-intervention executor thereof and pursuant to his authority under Rem. Rev. Stat. §1463, Mr. Merrill immediately divided the community property into two equal parts. One part he handled as his own; the other was taken over and reflected in his books of account as executor (R. 13).

In due course when the estate was in condition to be closed, Mr. Merrill exercised the option accorded non-intervention executors by Rem. Rev. Stat. §1462 and filed a report and petition for distribution. Upon the hearing of that report, the probate court entered a decree of distribution pursuant to this statute (R. 12, Ex. B). In this decree, it was provided that the executor was authorized to pay himself for his services as executor in the probate of the estate, the sum of $20,000. This decree was entered on November 22, 1939 (R. 12).

In the belief that this executor's fee was payable out of his wife's portion of the community estate, Mr. Merrill paid himself the full amount thereof out of the estate account in which that portion was on deposit. He took payment in two installments. The first, in the sum of $12,500, on December 23, 1939; and the second, in the sum of $7,500, on December 10, 1940 (R. 13).

In his individual income tax return for 1939, Mr. Merrill included the $12,500 received during that year (R. 13).

He did not report the $7,500 which he received in 1940 in his income tax return for that year (R. 14). The reason for this was that within a few days after he had taken the second installment of his fee, it happened that he was interviewed by the Internal Revenue Agent who was conducting the investigation of the estate tax return which Mr. Merrill had filed as executor (R. 13, 14). This agent pointed out to Mr. Merrill that under the decision of this court in *Lang's Estate v. Commissioner*, 97 F.(2d) 867, only one-half of the executor's and attorney's fees could properly be paid out of Mrs. Merrill's share of the community property and that only one-half could be properly claimed as a deduction for purposes of computing the Federal estate tax, instead of the full amount thereof as set forth in the return. Mr. Merrill acquiesced in the position of the Agent and paid the Federal estate tax promptly in accordance with that position (R. 15).

Realizing that he had appropriated to himself $10,000 of trust funds to which he was not entitled as well as having used funds of the trust, without right, to discharge his personal obligation for one-half of the attorney fees, Mr. Merrill consulted Mr. Justin Martin, a certified public accountant of the firm of Ernst & Ernst, who had supervised his individual accounts and those of the estate throughout the period (R. 34, 35). The latter recommended that these excess payments be regarded as being merely an advance and that Mr. Merrill be charged therewith on the books (R. 36). In accordance with this recommendation, forms of entries suggested by Mr. Martin as appropriate to the purpose were actually entered in the books both of Mr. Merrill and of the estate (R. 36). These entries were actually made on December 31, 1940, during the same month in which Mr. Merrill took the second installment of his executor's fee (R. 15).

In view of this, Mr. Merrill did not report this second installment as income in his income tax return for 1940 (R. 16, 17). By a report dated September 16, 1946, an Internal Revenue Agent recommended a deficiency based in part on this omission (R. 17, Ex. G). Mr. Merrill paid the deficiency (R. 17).

Mr. Merrill filed timely claims for the refund of the portion of his income which was based upon the inclusion of this sum of $10,000 of executor's fees in the computation of his gross income for the years 1939 and 1940 (R. 14, Ex. D; R. 17, Ex. I). The claims were based upon the grounds hereinafter urged. Admittedly the instant action was timely filed after the rejection of the 1939 claim and the passage of the statutory period of inaction following the filing of the claim for 1940.

## SUMMARY OF ARGUMENT

### I.

In Washington, each of the spouses has an equal, vested, undivided interest in community property. Upon the death of the wife, the husband's half does not cease to be his and become part of the decedent's estate. His half, like the decedent's, is subject to probate, but, unlike her half, his half never becomes part of her estate.

### II.

Where all of the estate of the decedent consists of her interest in community property, only one-half of the community debts and of the general expenses of administration can properly be paid from her half. Included in such expenses of administration are executor's fees for ordinary services.

III.

Where the surviving husband is the executor, since only one-half of his allowed fee can be paid out of his wife's half of the community property, the other half must come out of property which is already his. To the extent only, therefore, that he is paid out of his wife's half, does he derive taxable income.

## ARGUMENT

Agreeing with our analysis of the law as set forth in the foregoing summary, Judge Lindberg granted judgment in favor of Mr. Merrill. We believe the propositions asserted are not subject to well-informed doubt and that the conclusion of the District Court therefrom was palpably right and that the judgment should be affirmed.

I.

In Washington, each of the spouses has an equal, undivided interest in community property. Upon the death of the wife, the husband's half does not cease to be his and become part of the decedent's estate. His half, *whether in real or personal property*, like the decedent's, is subject to probate, but, unlike her half, his half never becomes part of her estate.

Some of the assertions in Appellant's brief regarding the community property law of the State of Washington are astonishing. One such, is the pronouncement, based upon a mistaken *dictum* in the case of *Commissioner v. Larsen*, 131 F.(2d) 85, 87, that upon the death of one spouse, title to the community personal property vests in the executor (Br. 10). Washington law is well settled to the contrary.

In discussing the community property statute of Washington (now set forth as Rem. Rev. Stat. § 1342), the Supreme Court of the state as early as 1896, pointed out that the statute made no distinction between real and personal property. *In re Fort's Estate*, 14 Wash. 10, 13.

That this is still the law is evidenced by the case of *In re Turner's Estate*, 191 Wash. 145, 148, wherein it is said:

> "Ever since *In re Fort's Estate*, 14 Wash. 10, 44 Pac. 104, it has been the law of this state that there is no essential distinction between real and personal property in this state, and that the word 'inheritance,' as used in the law of descent, applies as well to personalty as to land; and, under both §1364 and §1366, *supra*, this court has uniformly held that the estate vests immediately in the heir or devisee entitled thereto upon the death of the ancestor, subject only to rights of creditors."

To the said effect, see,

*In re Verchot's Estate*, 4 Wn.(2d) 574, 582;

*Johnson v. McClure*, 5 Wn.(2d) 123, 134.

While the community property statute of Washington (Rem. Rev. Stat. §1342) does contain provisions regarding the descent of community property, the first sentence of the statute is in no sense such a provision. This sentence of the statute has been in effect since 1875. It reads:

> "Upon the death of either husband or wife, one-half of the community property shall go to the survivor, subject to the community debts, and the other half shall be subject to the testamentary disposition of the deceased husband or wife, subject also to the community debts."

This sentence has been uniformly construed by the Supreme Court of Washington and by the Supreme Court of the United States just as if the expression "shall continue to belong" were substituted for the verb "go." As construed, the sentence is identical in substance with the provisions of the California statute referred to in footnote 2 on p. 390 of the decision of this court in *Bishop v. Commissioner*, 152 F.(2d) 389.

A striking case supporting this contention is *In re Coffey's Estate*, 195 Wash. 379, 382, wherein the court said:

> "The interest of the wife in the community estate in this state is not a contingent or expectant interest, but a present, undivided, one-half interest. *Marston v. Rue, supra; Schramm v. Steele*, 97 Wash. 309, 166 Pac. 634; *Poe v. Seaborn*, 282 U.S. 101, 75 L. Ed. 239, 51 S. Ct. 58. *No new right or interest is generated in the wife by the death of her husband; his death merely affords the occasion for the termination of the husband's interest in the community estate.*" (Italics ours)

We call this a striking case because it raised the question of the extent to which proceeds of life insurance purchased with community funds were taxable under the inheritance tax laws. It decided, of course, that only one-half of such proceeds were includable in the estate.[1] That was not the striking feature of the case. The amazing feature was that apparently this was the first time anyone had ever contended that more than half of community assets constituted portions of a decedent's estate despite the sweeping provisions of the Washington inheritance tax law (Rem. Rev. Stat. §11201, §11202). It has always been conceded in Washington, that there is no transfer of any additional interest in community property to the surviving spouse upon the death of the other member of the community. (See *In re Heringer's Estate*, 38 Wn. (2d) 399, 405.)

The foregoing authorities could also be cited in support of the proposition that although the surviving spouse's interest in community property in Washington is subject to probate, just as in California since 1927, the surviving spouse's interest never becomes a part of the deceased spouse's estate. This clearly recognized principle is well stated, also, in the case of *Wittwer v. Pemberton*, 188 Wash. 72, 76, as follows:

> "While under the law the entire community estate is brought into court to be administered upon, only half thereof is inherited, and that half may not go to the survivor of the community."

See, also:

*Goulette v. Goulette*, 114 Wash. 689, 691;

*Redelsheimer v. Zepin*, 105 Wash. 199;

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[1]Cf. *Lang v. Commissioner*, 304 U.S. 264, 82 L. Ed. 1331.

*Lang v. Commissioner* (C.A. 9) 97 F.(2d) 867, 871.

It is probably true under Washington law that until the community debts are paid and the expenses of administration are discharged, a lien therefor exists against the interest of the survivor as well as against that of the deceased member of the community. Properly considered, the case of *Thatcher v. Capeca*, cited by Appellant (Br. 9), goes no further than this, although it involved intestate succession rather than testamentary disposition by the decedent. To the extent to which such a lien arose by reason of the services of a surviving spouse as executor of his deceased wife's estate, the lien against his own portion of the community property would, of course, be extinguished under the doctrine of merger.

We believe, then, that we have shown that Judge Lindberg was right in concluding that Mr. Merrill's interest in his community property was not diminished upon the death of his wife, under Washington law.

## II.

Under Washington law, only one-half of the executor's fee for settling a community estate may be collected from the interest of the decedent in the community property.

Judge Lindberg's decision that under the law of Washington only one-half of the fee allowed to an executor for his ordinary services can be charged to the decedent's interest in the community property under the circumstances here involved, is apparently not challenged (Br. 13). It is a necessary implication of this court's decision in the *Lang* case.

This brings us to the final major point.

III.

Only to the extent to which a surviving husband's fee as executor is payable or paid out of his deceased wife's share of the property, does he derive taxable income.

When Mr. Merrill acquiesced in the Revenue Agent's contention and acknowledged that he was only entitled to collect half of the fee, which the probate court had allowed him, out of his deceased wife's share of the community property and treated the excess payment as a loan which he subsequently repaid, can it be properly said that Judge Lindberg was wrong in holding that, as to such excess, Mr. Merrill derived no taxable income?

In the District Court, the brief which was prepared by the office of the Attorney General and submitted on behalf of the defendant placed reliance on S.M. 4623, which had also been the basis for the position which Revenue Agent Harney had taken in connection with the deficiency assessment here involved. The same ruling is relied upon in Appellant's Brief, with the observation that it reflects the position maintained by the Commissioner of Internal Revenue since 1925 (Br. 12). The text of the ruling does not appear in Appellant's Brief. In its latest form, it is as follows:

> "The law of the State of Washington is that the community is immediately dissolved upon the

death of one of its members and that title to half of the community properly vests absolutely in the surviving spouse upon the death of the other, subject only to the community debts and expense of administration.

"Accordingly, the claim of a widow against an estate for commissions as executrix thereof was superior to her claim as the surviving member of the community, and the entire commission received by her was income subject to tax (S.M. 4623, C.B. Dec. 1925, p. 40)."

1952 Prentice-Hall: Federal Tax Service, Vol. 2, par. 17072;

51 2 C.C.H., par. 455.203.

With the first paragraph of the foregoing ruling, we have no substantial quarrel. If, however, the ruling was made with reference to an estate which consisted entirely of community property—and counsel for the government so contended below—the concluding portion of the second paragraph squarely states the position with which we take direct issue.

Since this ruling was promulgated in 1925, before there were any authorities in this jurisdiction on the question of whether expenses of administration were chargeable against the entire community estate or solely against the interest of the deceased spouse, the person formulating it may have proceeded upon the assumption that the latter was true. If that were the law, the ruling would have been sound enough. In due time, however, it has been established that expenses of administration in this jurisdiction are not chargeable solely against the interest of the deceased spouse.

*Wittwer v. Pemberton* (1936) 188 Wash. 72;

*Lang's Estate v. Commissioner* (1938) 97 F.(2d) 867 (C.A. 9th);

*Estate of George V. Heringer* (1951) 38 Wn. (2d) 399.

When an executor is a third person of course this makes no difference as far as his income tax liability is concerned. His entire fee is income to him regardless of the property from which it is paid. When he is the surviving spouse, however, the situation is entirely different. Under these circumstances, he derives income only to the extent to which the fee is payable and paid out of his wife's property. To the extent to which it is paid out of, or chargeable to, his own property, the transaction at most would amount to "removing his own money from one pocket to another." This, we contend, does not constitute income within the taxing power of Congress under the XVIth Amendment.

Counsel asserted below that this ruling had never been criticized by the courts. That may be. We are aware of no decision, on the other hand, which has ever approved it. Certain it is, that it is squarely contradicted by the decision of this court in *Bishop v. Commissioner*, 152 F.(2d) 389. That decision says on this point at p. 390:

> "For her services as executrix, petitioner was paid in 1940 a fee of $1,928.09. The fee was paid from community funds — in other words, from funds one-half of which belonged to petitioner. In her income tax return for 1940, petitioner reported one-half of the fee. The Tax Court held that

the entire fee was income of petitioner and should have been so reported by her. In this the Tax Court erred. One-half of the fee having been paid from petitioner's funds, only the other half constituted income of petitioner."

We submit that the foregoing pronouncement of the law by this court should control the decision in this case and that on this point it cannot be distinguished. As we have already pointed out, the provisions of Washington law in this respect are substantially identical with the provisions of the California statute which this court had under consideration.

We may be laboring the point unduly but it appears to us that there can be no doubt but that this decision accords with fundamental concepts of what constitutes income. As Judge Learned Hand said in *Schlemmer v. U. S.* (C.A. 2) 94 F.(2d) 77, 78:

"There must be more than difference in the mere form of property to justify a charge of income."

Upon this principle the Supreme Court of the United States has consistently held that an ordinary stock dividend is not income and that the 16th Amendment accordingly gave Congress no power to tax such a dividend. In *Eisner v. Macomber*, 252 U.S. 189, 64 L.ed. 521, the court established this point and from the position there taken, there has been no departure. Of course there was a change in the form of property in the stock dividend cases which is not present here. Here not even the form was changed, so the reasoning of the Supreme Court applies with even greater force. The essential test is expressed by the Supreme Court in this language (252 U.S. 202, 64 L.ed. 527):

"A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished, and their interests are not increased * * *. The proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original shares together representing the same proportional interest that the original shares represented before the issue of the new ones. *Gibbons v. Mahon*, 136 U.S. 549, 559, 560, 34 L.ed. 525, 527, 528, 10 Sup. Ct. Rep. 1057. *In short, the corporation is no poorer and the stockholder is no richer than they were before. Logan County v. United States*, 169 U.S. 255, 261, 42 L.ed. 737, 739, 18 Sup. Ct. Rep. 361." (Italics ours)

See, also:

*Towne v. Eisner*, 245 U.S. 418, 62 L.ed. 372.

Upon this universal principle it is clear that to the extent his allowed fee as executor of his wife's estate was payable or paid out of his own property, Mr. Merrill was no richer after the payment than before. To that extent, accordingly, he derived no income from the payment or allowance of the fee.

Counsel cite a number of cases dealing with the question of who, as between a fiduciary and a beneficiary, is required to account for income, or entitled to claim loss deductions under the Federal income tax law. No such problem is here involved. This case is not concerned with the income of the estate. It has to do solely with the taxability of a single item of income in the individual returns of the recipient. Hence we do not deem it essential to enter upon a critical examination of these cases nor to discuss the assertion that, for purposes of Federal income taxation, an estate is an accounting unit and may, to that extent, be deemed a separate entity.

As we read those cases, however, it seems that they all agree that the question of who is the owner of the property producing the income is a question of state law. Under Washington law, the marital community is not a separate legal entity, or juristic person, although for convenience the term is frequently used by way of metaphor in so describing it. *Bortle v. Osborne*, 155 Wash. 585, 589. Neither under Washington law, as we have above demonstrated, is the estate of a deceased spouse a separate legal entity to which any portion of the surviving spouse's interest in community property passes upon the death of his mate. In no sense, under Washington law, does the surviving husband's half of the community property cease to be his and become a part of the decedent's estate.

With this general observation we might properly pass the reference in Appellant's Brief to the decision of this court in *Commissioner v. Larson*, 131 F.(2d) 85, were it not for the fact that it contains assertions concerning Washington law and is so heavily relied upon by Appellant. That case was actually concerned solely with the question of who, in the State of Washington, is accountable for income tax on the income of community property during the period of administration when the estate is administered under an ordinary will or as an intestate estate. In that case Adelbert Larson, the husband, died leaving a will which named a bank as executor. Neither the opinion nor that of the Tax Court (44 B.T.A. 1094), which it reviewed, indicated that the will of the decedent made any provision regarding the disposition of income. The Tax Court held that the income of community property under these circumstances was taxable to the estate and that the surviving wife was not taxable on half of it because she had no right to the income during the taxable year (44 B.T.A. 1102). This court affirmed on the ground that the "ownership" of the income from the community property under the circumstances there before the court was in the executor and that he should report the whole income of the estate (131 F.(2d) 87).

We are confident that we shall be able to demonstrate that the *Larson* case is neither factually nor legally apposite to any problem here involved. For this reason, we believe that this court is not strictly required to pass upon the present authority of that case. Frankly we do not know and the bar of Washington generally is in doubt as to what extent it is still a binding precedent on its facts. It has never been expressly overruled. Yet it was distinguished three years later, in *Bishop v. Commissioner*, 152 F.(2d) 389, 391, wherein this court held that the surviving spouse, under similar circumstances, must report one-half the income of community property.

The asserted ground of distinction is that the laws of Washington involved in the *Larson* case differ respecting rights in community income from those in the *Bishop* case where California law was involved. Nothing explicit in the decisions however reveals any substantial distinction. Further, when one remembers that the once existing difference discussed in *U. S. v. Robbins*, 269 U.S. 315, 70 L.ed. 285, and *Poe v. Seaborn*, 282 U.S. 101, 75 L.ed. 239, was removed by legislation in California on July 29, 1927 so that *Poe v. Seaborn* became the law in California (*U. S. v. Malcolm*, 282 U.S. 792, 75 L.ed. 714), one is mystified the further by the suggestion that there is now any difference between the essential characteristics of community property in Washington and California.

Neither is any helpful light shed upon the problem by the fact that the case of *Masterson v. Commissioner*, 141 F.(2d) 391, 392 (C.A. 5th) which cited the *Larson* case with approval is not referred to in the *Bishop* case. Nor by the fact that the same court which rendered the *Masterson* decision under Texas law, arrived at a conclusion like that of the *Bishop* case and contrary to its earlier *Masterson* case, in a similar question arising under Louisiana law in *Henderson's Estate v. Commissioner*, 155 F.(2d) 310, without citing any of those cases. Nor is the confusion lessened by the fact that the Court of Appeals for the Fifth Circuit in its latest pronouncement on the subject follows the *Henderson* case and applies the Louisiana rule in Texas, without any reference to its own apparently contrary ruling under Texas law in the *Masterson* case. (*Blackburn's Estate v. Commissioner*, 180 F.(2d) 952.) In such a situation, one cannot but sympathize with the plaint of the Tax Court in *Estate of J. T. Snead, Jr.*, 17 T.C. #160.

Upon one point all of these cases agree. That point is that the question of who is entitled to, and hence required to report, community income during the period of administration of the estate of a deceased member of the community, is a question of state law. The *Larson* case certainly asserts that this right and obligation rest solely in the personal representative of the deceased husband under the facts of that case and under the law of the State of Washington as applied to those facts. Since the facts of the instant case, as we shall hereinafter point out, make the *Larson* case inapplicable in any event, we might well abandon further discussion of it as purely academic. It does seem to us, however, that it apparently misinterprets Washington cases upon which it relies. We know of no authority in this state which indicates that the husband's vested interest in the community property is divested by his wife's death. We have cited controlling authority to the contrary. Hence, were it material, we would contend that the rule of the *Bishop*, *Henderson* and *Blackburn* cases, rather than that of the earlier *Larson* and *Masterson* cases, is applicable in our jurisdiction.

But, as we have said, we regard the point as academic and not necessary for decision here because the *Larson* case, on its facts, does not apply to the instant situation. As above pointed out, the will in the *Larson* case *did not provide for settlement of the deceased husband's estate without court intervention and it made no bequest of income*. These distinctions are clear, important and decisive.

Both the fact and the importance of the difference are recognized in the Federal and in the state authorities. Speaking of the *Larson* will, the Board of Tax Appeals said:

> "This was not the case of 'a nonintervention will' in which, upon a showing of solvency, the estate may be administered without court approval. Here each sale and distribution required court sanction and petitioner could only receive the income in question as a distribution from the estate. The facts of the case at bar present petitioner's view in the strongest possible light. Since the community property was subject to administration and income therefrom was receivable by the estate during administration, we believe it would be contrary to the intendment of section 161(a)(3) of the Revenue Act of 1934 to tax any part of that income to petitioner. In spite of petitioner's vested interest in the property, she had no right to the income during the taxable year." (44 B.T.A. 1102)

Under Washington law, settlement of estates without court intervention is essentially different in character from ordinary administration. As the Supreme Court said in *Schubach v. Redelsheimer*, 92 Wash. 124, 127:

> "Our statutes provide two ways for probating estates under wills, one method being to probate the will under the direction of the court, and the other, as directed in Rem. & Bal. Code §1444, to settle it without the intervention of the court after certain acts have been done."

The powers and duties of an executor under a nonintervention will do not stem from the statutes relating to ordinary executors which are set forth in the Appendix to Appellant's Brief. On the contrary, they derive their statutory sanction from Rem. Rev. Stat. §§1462, 1463, which are set forth in the Appendix to this brief, *infra.* (See *In re Krueger's Estate,* 180 Wash. 165, 168).

Further it is conceded that Mrs. Merrill's will, unlike the one in the *Larson* case, made an express bequest of the income of her property. She left it to her husband for life (Br. 3).

Under such circumstances, as hereinafter demonstrated, the law of this state is clear that income during the period of administration may not be used to pay the expenses of administration. Appellant argues that if paid out of income, such expenses might be used as a deduction in the income tax return of the estate to the extent to which they were not used as a deduction for estate tax purposes (Br. 12). Since income could not, under our law, be used for the purpose and since there is no showing that this law was violated, it seems to us unnecessary to discuss at length the argument of counsel on the point. It is admitted that under the regulations in force at the time the estate income tax returns were made in this case, no deduction could have been claimed in these returns for such payments even if made out of income (T.D. 5166). Counsel argue, however, that because some five years after these returns were due (and only following the change of law made in the Revenue Act of 1942) this inhibition was retroactively removed by T.D. 5513 (which became effective May 14, 1946) (Br. 20) this should be regarded as a statutory sop for the obviously unfair treatment which counsel contend should be Mr. Merrill's lot. The argument is unrealistic. The regulations in force at the time the returns were made precluded any such salvage by Mr.

Merrill, even if income could have been used for the purpose. The fact that the regulations were changed five years later — when it was too late for Mr. Merrill to have done anything about it — is immaterial, even though the new regulation was intended to be retroactive. Mr. Merrill could not and did not (as Mr. Martin testified—R. 40, 41) claim any income tax deductions based upon the $10,000 of the fee which was not claimed as an estate tax deduction.

As we have said, under Washington law under the facts of this case, income could not be used to pay administration expenses.

In *Williamson's Estate*, decided March 15, 1951, the Supreme Court of the State of Washington squarely settles this point in the following language:

> "In the case of an ordinary will, even though there be a dual administration and trusteeship, the executors might have such right of possession and control over the income as to enable them to hold it as a part of the estate funds and out of it defray and pay such items as taxes, insurance and necessary expenses in the upkeep of the income property, but under a nonintervention will setting forth such a plan as appears in the will before us, the right to receive income from the death of the testatrix becomes apparent." 38 Wn. (2d) 259, 265.

Further, the court says:

> "The intention of the testatrix, coupled with the statute, made it mandatory that the expenses of administration be paid out of the corpus of the estate. We have found no case in this state deciding this precise question. Having reached

> the conclusion that both the will and the statute contemplates payment of administration expenses out of the corpus of the estate, it would seem that reference to authority would be unnecessary. However, reference may be made to 33 Am. Jur. 946, Life Estates, §424; 135 A.L.R. 1322, and *Estate of Schiffmann.* 86 Cal. App. (2d) 638, 195 P. (2d) 484." 38 Wn. (2d) 259, 266.

Accordingly we submit that any question about income from this property during the period of administration is immaterial and the *Larson* case is not at all in point. Should this court, however, see fit to incorporate in the opinion herein, a dictum concerning the present authority of that case, it would help resolve the doubts of many members of the Washington bar and would undoubtedly be welcomed by them.

We have no quarrel with the assertion by counsel that the disallowance of part of a fee as a deduction for purposes of the estate tax, because unreasonably large, is not a determination of whether such fee, when paid, constitutes taxable income, if this is the point to which counsel cite *Anderson v. Bowers* (C.A. 4) 170 F. (2d) 676, at page 14 of their brief. But no such question is here involved. Here the *amount* of the fee has never been challenged. It was set by the state court and the amount of it was approved in the audit of the Estate Tax Return. The only question here was whether the whole fee, or only half, could be taken from Mrs. Merrill's share of the community property. Mr. Merrill acquiesced in the position that under the *Lang* case, only one-half could be taken from her half and hence that only one-half of the fee could be claimed as a deduction in the Estate Tax Return. We contend that since only one-half could be taken from her half, the other half of the fee, if paid at all, could only be paid out of Mr. Merrill's half (his own property) and that, whether paid or not, this half did not constitute income to him.

If the *Anderson v. Bowers* case is cited as authority for the further proposition that the doctrine of constructive receipt is applicable to the facts of this case and that Mr. Merrill constructively received the full fee of $20,000 because he had available funds of Mrs. Merrill's portion of the estate under his control at that time to have paid himself the full allowance[2] rather than merely an installment of $12,500 which he took in 1939, this amounts to a confession that the judgment herein as to the second cause of action is correct, apart from any consideration of the main question which has been argued in these briefs.

If the government contends that Mr. Merrill received the full $20,000 in 1939, it is obvious that the Revenue Agent was wrong in adding $7,500 of it to Mr. Merrill's returned income in 1940 and that our contention in this respect is admitted.

> *McEuen v. Commissioner* (C.A. 5) 196 F. (2d) 127;
>
> *Weil v. Commissioner* (C.A. 2) 173 F.(2d) 805, Cert. den. 338 U.S. 821;

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[2]On December 30, 1939, the estate of Eula Lee Merrill had on deposit the sum of $12,281.76 after the payment of the $12,500 to R. D. Merrill by check dated December 23, 1939 (R. 13).

*Ross v. Commissioner* (C.A. 2) 169 F.(2d) 483, 492;

7 A.L.R.(2d) 735.

On page 14 of Appellant's Brief reference is made to the case of *United States v. Lewis*, 340 U.S. 590. If by this reference counsel seek to raise the doctrine of receipt under a claim of right which the *Lewis* case supports, we wish to call to the attention of the court that this is the first time in this litigation that such a point has ever been raised. We, of course, do not know the reason for the delay. We do know, however, that at the time this case was tried below, if the point had been seasonably raised we would have had opportunity to file a claim for refund based on a loss sustained in 1943,[3] in accordance with the formula approved in the *Lewis* case, for any part of the recovery which might have been denied us in this case by reason of the application of the doctrine of the *Lewis* case. At the time of the trial below, 1943 was still a year open to adjustment as far as Mr. Merrill's income tax liability was concerned. That is not true now. The statute has run in the interim. Under such circumstances, we do not believe that this court should consider the point. *United States v. Waechter* (C.A. 9) 195 F.(2d) 963.

The *Lewis* case, in any event, could not apply to the second cause of action, involving the year 1940. The doctrine of the *Lewis* case, as we understand it, is based upon supposed practical necessity which requires each

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[3]The overpayment was actually repaid on August 14, 1943 (R. 16).

tax year to be treated as a separate package. If a taxpayer receives a payment during a given year and in good faith claims it to be income, he must report it as such, even though it is established in a subsequent year that his claim was not valid. No case applying the doctrine has ever held, so far as we have been able to discover, that it forbids adjustments *within* the year.[4] If a client by mistake overpays me and during the year the mistake is discovered and the obligation to repay the excess is acknowledged, such excess does not constitute income. If I actually repay the item during the year, this is obvious. Nor logically does it make any difference in case my client and I agree that the excess shall be considered a loan or advance which I am to repay at a future date. (See *Carey Van Fleet*, 2 B.T.A. 825.) This is precisely what happened in the instant case. During the very month in which he received the second installment, Mr. Merrill acknowledged the mistake, and had the accountant make appropriate entries to rectify it. Subsequent actual repayment merely confirmed the bona fide character of the whole transaction. Nothing in the *Lewis* case would require extension of its admittedly harsh rule to cover such a situation.

We cannot believe that counsel are serious in suggesting that Mr. Merrill, a trustee who had admittedly appropriated to his own use more of the trust funds than was his due, is not shown to have been obligated to return the overpayment. For this reason we shall not discuss the case of *Crellin v. Commissioner*, 17 T.C. 781, wherein the decision was based upon the holding

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[4]See *Curran Realty Co. v. Commissioner*, 15 T.C. 341.

that under the facts there involved, there was no such obligation.

Having above demonstrated that Mr. Merrill's sole income from the executor's fee was derived in 1939, we believe we have thereby fully answered Appellant's alternative contention (Br. 15).

## CONCLUSION

For the foregoing reasons, we urge that the judgment of the District Court should be in all respects affirmed.

Respectfully submitted,

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# APPENDIX

## Remington's Revised Statutes of Washington

## XIII.

### Settlement of Estates Without Administration

§1462. Settlement without court intervention—Order of distribution—Mismanagement—Citation. In all cases where it is provided in the last will and testament of the deceased that the estate shall be settled in a manner provided in such last will and testament, and that such estate shall be settled without the intervention of any court or courts, and where it duly appears to the court, by the inventory field, and other proof, that the estate is fully solvent, which fact may be established by an order of the court on the filing of the inventory, it shall not be necessary to take out letters testamentary or of administration, except to admit the will to probate and to file a true inventory of all the property of such estate and give notice to creditors and to the state board or person having charge of the collection of inheritance tax, in the manner required by existing laws. After the probate of any such will and the filing of such inventory all such estates may be managed and settled without the intervention of the court, if the last will and testament shall so provide. But when the estate is ready to be closed the court, upon application, shall have authority and it shall be its duty, to make and cause to be entered a decree finding and adjudging that all debts have been paid, finding and adjuding also the heirs and those entitled to take under the will and distributing the property to the persons entitled to the same, such decree to be made after notice given as provided for like decrees in the estates of persons dying intestate. * * * (L. '17 p. 666, §92.)

§1463. Powers of nonintervention executors. Executors acting under wills such as are mentioned in the last preceding section shall have power, after the filing of an inventory of the estate, if the said estate has been adjudged solvent, to mortgage, lease, sell and convey the real and personal property of the testator without an order of the court for that purpose and without notice, approval or confirmation, and in all other respects administer and settle the estate without the intervention of the court. (L. '17, p. 667, §93.)